

TABLE 3. ANNUAL CASH SAVINGS FROM ONE YEAR'S A-76 ACTIVITY UNDER CURRENT LEVELS OF EFFORT (Full-year effects in millions of 1988 dollars)

| | Activities Remaining In-house | Activities Contracted Out | Total |
|-------------------------|-------------------------------------|---------------------------------|-----------|
| Management Improvements | | | |
| All activities | 20 | 0 | 20 |
| Defense | 15 | 0 | 15 |
| Nondefense | 5 | 0 | 5 |
| Contractor Operation | | | |
| All activities | 0 | 50 | 50 |
| Defense | 0 | 35 | 35 |
| Nondefense | <u>0</u> | <u>15</u> | <u>15</u> |
| Combined Impact | | | |
| All activities | 20 | 50 | 70 |
| Defense | 15 | 35 | 50 |
| Nondefense | 5 | 15 | 20 |

SOURCE: Congressional Budget Office.

NOTE: Annual cash savings represent decreases in budget outlays and any net losses in federal collections from employee contributions. Figures rounded to nearest \$5 million.

Reductions in Cash Costs

According to CBO estimates, the A-76 program's contribution to reducing the near-term costs of federal operations amounts to about half of its potential accrual cost savings. Average cash savings from one year's effort to improve federal management and to contract out would total about \$70 million on a full-year basis--compared with the \$130 million reduction in accrual costs (see Table 3). As previously mentioned, smaller cash savings mainly reflect the fact that cash savings in retirement costs do not materialize right away.^{4/} Over a five-year period, about 36,000 federal

4. In addition, the A-76 program causes slight net cash losses in certain funds held by the government for retirement-related benefits. These declines, allowed for in CBO estimates, occur as the result of a net loss in employee contributions to federal Social Security, Medicare, and federal employee retirement funds. Under the unified federal budget, a decline in such cash contributions increases budget deficits. A fraction of the decline is offset by reduction in federal outlays for off-budget investment of employee contributions to retirement thrift plans.



jobs could be freed up, assuming agencies continue A-76 reviews covering 10,000 full-time workers annually. As a result, cumulative reductions in cash costs would average about \$200 million (see Table 4). For DoD activities, estimated cumulative cash savings would average \$140 million.

According to CBO estimates, for DoD and nondefense activities combined, total reductions in cash resources from contracting out could average about \$135 million through 1992. Another \$65 million in cash savings would be realized from improved management.

TABLE 4. CUMULATIVE CASH SAVINGS UNDER CURRENT LEVELS OF EFFORT, 1988-1992 (In millions of dollars)

| | 1988 | 1989 | 1990 | 1991 | 1992 | Five-Year Average |
|--------------------------------|------|------|------|------|------|----------------------|
| Management Improvements | | | | | | |
| All activities | 15 | 35 | 65 | 95 | 130 | 65 |
| Defense | 10 | 25 | 45 | 65 | 90 | 45 |
| Nondefense | 5 | 10 | 20 | 30 | 40 | 20 |
| Contractor Operation | | | | | | |
| All activities | 20 | 70 | 125 | 190 | 255 | 135 |
| Defense | 15 | 50 | 90 | 135 | 180 | 95 |
| Nondefense | 5 | 20 | 35 | 55 | 75 | 40 |
| Total | | | | | | |
| All activities | 35 | 105 | 190 | 285 | 385 | 200 |
| Defense | 25 | 75 | 135 | 200 | 270 | 140 |
| Nondefense | 10 | 30 | 55 | 85 | 115 | 60 |

SOURCE: Congressional Budget Office.

NOTE: Figures rounded to nearest \$5 million. Five-year averages rounded independently. Estimates include the effect of cost increases resulting from higher prices and assume A-76 reviews occur evenly throughout the year. In addition, the savings from each year's A-76 activity are considered to continue through the end of the five-year period covered by the estimates.

CHAPTER III

OPTIONS FOR THE GOVERNMENT'S

CONTRACTING OUT PROGRAM

Most actions the Congress would be likely to take in addressing the government's A-76 program would either increase contracting out or restrict it. The options described in this chapter represent both approaches.

Whatever the Congress decides is the best course of action to take with regard to A-76, it may choose from a number of methods to carry out its will. It could decide to bring about change by enacting specific authorizing legislation, or it could do so as part of its detailed review of agency appropriation requests. Appropriation action could take the form of specific language in appropriation acts or direction to executive agencies in accompanying committee reports. The Congress may also pursue changes as part of the exercise of its oversight responsibilities. Of course, it could also decide the current program is best and take no action.

As described in Chapter I, those who support contracting out, under current or expanded levels of effort, regard commercial activity as beyond the proper purview of government. They contend that, with federal deficits likely to continue, the A-76 program offers a way to reduce federal costs without reducing programs. Moreover, they argue that problems with contracting out can largely be dealt with through careful procurement management and better monitoring of contractor performance. Critics of contracting out, who would oppose most any expansion of the program, express concern about the loss of federal jobs to private firms, maintaining control of and accountability for activities performed by those outside government, and possible decreases in the quality of services received. Other critics complain about cost increases that sometimes follow contracting out and about the accuracy of cost comparison procedures.

OPTIONS FOR POTENTIAL COST REDUCTION

As Table 5 illustrates, the various options described in this chapter offer the potential to reduce federal costs, although they do so to varying degrees. The amounts presented represent the full effect of each option rather than changes from the current program. CBO adopted this approach because its





baseline projections of current policies for major operating programs make no explicit assumptions about changes in either the size of the federal work force or federal costs that would result from management improvement efforts such as A-76. 1/

As with the estimates in the previous chapter, those presented here reflect assumptions about the portion of activities to be contracted out and about projected average savings. Both assumptions are based on the extensive experience DoD has had with A-76. Resources freed up under any of the options described could be applied to reducing federal deficits or to fulfilling other program requirements. CBO's estimates assume that options to expand the contracting out program could be carried out largely without layoffs. Even so, expanded contracting out could prove a hardship for some employees. Achieving an orderly transfer of jobs becomes increasingly difficult as more activities are affected. As a result, some employees may have to face unwelcome changes in job location, level of responsibility, and working conditions. About 70 percent of the estimated cost and job impacts described below pertain to activities at the Department of Defense.

The Current Program

Should the Congress make no changes in the A-76 program, management improvements and contracting out under current efforts would together generate cumulative reductions in cash costs averaging \$200 million over the 1988 through 1992 period (see Table 5). On an accrual basis, cost reductions over the same period would average \$325 million. The program would free up about 7,200 federal jobs each year.

Option I: Increase The Number of A-76 Reviews

This option would expand contracting out by increasing the number of A-76 reviews that agencies do each year. Critics of current efforts have long maintained that agencies simply do not do as many reviews as they could. Agencies regularly fail even to perform as well as they tell OMB they will. For example, according to unpublished OMB data for the 1984 through 1986 period, agencies promised annual reviews of activities that, when combined, covered about 30,000 jobs but completed reviews for only about 10,000 of them per year. OMB set goals for agencies during the three-year period

1. The implicit assumption in CBO baseline projections is that current levels of activity under A-76 continue throughout the estimating period.

that would have totaled reviews covering almost 35,000 jobs per year. Moreover, agencies appear to have the resources available to expand annual reviews; they employ nearly 25,000 mid-level management and program analysts capable of conducting cost comparisons and management studies. Of the various options described in this chapter, expanding A-76 reviews offers the greatest potential to reduce federal costs.

The Congress could do a number of things to expand A-76 activity. It could, for example, reduce legislative restrictions on contracting out. While concern for national security and the quality of care provided to veterans gave rise to the largest legislative restrictions on contracting out, some analysts argue that they are overly restrictive and overused. Because of such restrictions, for example, the Veterans Administration does virtually no

TABLE 5. AVERAGE ANNUAL COST AND JOB REDUCTIONS FROM
OPTIONS FOR THE A-76 PROGRAM, 1988-1992

| | Job Reductions | Reduction In Cash Costs (In millions of dollars) | Reduction In Accrual Costs (In millions of 1988 dollars) |
|------------------------|----------------|---|--|
| The Current Program | 7,200 | 200 | 325 |
| Option I | 14,400 | 400 | 650 |
| Option II | 20,000 | 140 | 305 |
| Option III | 4,000 | 370 | 430 |

SOURCE: Congressional Budget Office.

NOTE: Dollar amounts have been rounded to the nearest \$5 million. Both the cash and accrual estimates assume A-76 reviews occur evenly throughout a year and that savings from each year's reviews continue through the end of the five-year estimating period. In addition, cash savings have been adjusted to reflect price changes.



contracting out despite its very large commercial work force. Reducing statutory restrictions, however, would run counter to some legislation now pending in the Congress. 2/

Providing a specific statutory base for contracting out, which is now an Executive Branch initiative, might also encourage more A-76 activity. Such a statute might well include schedules of reviews to be undertaken by agencies. Legislation of this sort has already been proposed. 3/ The Congress might also consider encouraging more A-76 activity by taking action to reduce employee resistance to contracting out. It could, for example, consider mandating job placement in the same commuting area for federal employees affected by A-76. 4/

While it is difficult to predict precisely by how much the program would grow in response to the this option, it is not unreasonable to assume agencies could review activities covering 20,000 jobs annually--twice the current level. Accordingly, cost and job reductions under the program would probably double.

Option II: Shift Activities To The Private Sector Without Cost Comparisons

As another approach to expanding contracting out, the Congress could require the Executive Branch to shift activities to private firms without making cost comparisons. This approach would be in the spirit of the government's original contracting out policy, which rested on the belief that the government simply should not be in the business of providing support services available from commercial sources. The option would place maximum reliance on the private sector. Activities that would otherwise have

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2. S. 736, introduced as H.R. 1302 in the House, would expand existing prohibitions in contracting out at the Department of Defense.
 3. Bills S. 265, H.R. 136, and H.R. 1606 would all provide statutory authority for contracting out. In addition, the two House bills recommend adoption of schedules that would mean completing cost studies for all eligible activities over a five-year period.
 4. Another, but perhaps costly, approach could be modeled after ideas advanced by the Office of Personnel Management (OPM). OPM believes employee opposition to contracting out would be reduced if the government required private firms seeking federal contracts to give stock in the enterprise to federal employees who must leave government because of the conversion. Some further details about OPM's ideas are provided in the *Budget and Program* newsletters of August 15, 1986 and March 27, 1987.

remained in-house to reduce federal costs would shift instead, and agencies would most likely complete more procurement actions in the absence of lengthy and controversial cost comparison procedures. The option would not maximize savings, however, since economies would no longer be guaranteed for every activity converted. (Agencies could avoid extraordinary cost increases if they were permitted to forgo contracting out in cases where private firms clearly could not provide the service at a reasonable price.)

The cost increases for some activities under this approach might compound the difficulties agencies experience in complying with any other budget reduction requirements they face. In addition, without a competitive process that pits in-house against contract operations, private firms in locations where they encounter little competition would not have much, if any, incentive to offer the government their best price. Moreover, agencies would give up cost reductions from management improvements for those activities that would have otherwise remained in-house.

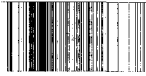
If agencies shifted some 20,000 jobs each year, cumulative average annual reductions in cash costs through 1992 would total \$140 million--only about 70 percent of the savings under the current program. Accrual savings over the same period would average \$305 million.

Option III: Suspend Contracting Out

Moving in the opposite direction, the Congress could act to suspend contracting out. Such a suspension might be permanent, in recognition of the continuing controversy surrounding the A-76 program, or it could be temporary, providing an opportunity for both the Executive and Legislative Branches to consider fully any changes in the program. A temporary moratorium, for example, would permit the government to study more thoroughly the effect of federal retirement reform on federal costs.

Under this option, contracting out would be suspended through 1992 and management reviews would be expanded to help offset lost savings. CBO estimates assume that agencies could conduct reviews covering about 20,000 jobs per year. Without the threat of contracting out, however, the Congress would have to consider methods to help ensure that agencies continued to find substantial management savings. In the past, such savings have averaged around 20 percent of in-house costs. The Congress might, for example, reduce agency budget requests to reflect expected savings from management improvements. It could also require audit reports to verify that improvements cited in management reviews were carried out.





Under this option, if agencies conducted annual reviews covering some 20,000 jobs, management improvements could permit the government to free up some 4,000 jobs annually. Potential reductions in cash costs would average \$370 million through 1992, while average annual accrual savings would amount to \$430 million. (These CBO savings estimates assume agencies would continue to find savings averaging 20 percent of in-house costs.)

APPENDIX

ESTIMATING POTENTIAL COST REDUCTIONS

FOR THE A-76 PROGRAM

The Congressional Budget Office calculated the impact of the A-76 program by first estimating the in-house costs of activities covered by future A-76 reviews. These estimates assume that, annually from 1988 through 1992, agencies will conduct A-76 reviews for activities covering the equivalent of 10,000 full-time workers--7,000 at DoD and 3,000 at non-defense agencies. According to unpublished OMB data on A-76 accomplishments, the 10,000 estimate represents about the average number of jobs covered per year by A-76 reviews for fiscal years 1984 through 1986. The estimates further assume jobs covered by future A-76 reviews will have an average salary of \$23,900, in 1988 dollars, based on data from OPM on pay and employment in commercial-type occupations. CBO derived total in-house costs from pay, assuming a relationship between the two costs consistent with data from DoD cost comparisons.

Against its estimates of in-house cost, CBO then applied key estimating factors representing assumptions concerning the rate of conversion to contract and the average savings per A-76 review. These factors were derived from a detailed analysis of DoD data. CBO had available the results of A-76 activity at DoD for the years 1983 through 1986. In addition, CBO was able to obtain the individual cost comparisons prepared for 1985, which it used to consider the effects of adjustments in various cost factors included in cost studies. 1/

AVERAGE SAVINGS

The following table compares the average savings rates implicit in CBO estimates with those achieved by DoD for the three-year period following the major revisions in A-76 policy which occurred in 1983.

Generally, the CBO assumptions are conservative when compared with those generated from DoD data. The conservative factors reflect several

1. DoD's Commercial Activities Directorate provided the cost comparison data base, CBO edited it to correct for a few minor errors and omissions.



considerations, although no precise adjustment could be substantiated. First, private-sector salaries for many occupations continue to grow more than those in the federal government, potentially reducing the margin of savings that contractors can offer to government. Second, the government may not always realize the full savings from jobs abolished under A-76, because of benefits available to employees in the affected jobs. Federal workers in jobs abolished, for example, may take the position of lower-paid workers with less seniority while retaining their previous grade and pay.

APPENDIX TABLE. A COMPARISON OF CBO ESTIMATING FACTORS AND DoD DATA

| | DoD Experience | | | CBO Assumptions | | |
|---|----------------|------|------|------------------------|-----|---------|
| | 1984 | 1985 | 1986 | All Agencies <u>a/</u> | DoD | Non-DoD |
| Average Percent Savings for Activities Converting <u>b/</u> | 41 | 38 | 38 | 35 | 36 | 33 |
| Average Percent Savings for In-House Management Improvement <u>b/</u> | 22 | 20 | 23 | 20 | 20 | 20 |

SOURCE: Congressional Budget Office and Department of Defense.

NOTE: Information on DoD experience derived from agency information as reported, without CBO adjustments.

- a. Figures included under all agencies represent a weighted average that reflects the assumed number of reviews DoD and non-DoD agencies will perform.
- b. Average savings are expressed as a percent of in-house costs before contracting out or management improvements.

Moreover, should contracting out result in layoffs, affected workers may be eligible for severance pay and other benefits that increase costs. 2/

The conservative CBO factors also reflect consideration of two phenomena that will affect the potential savings of future A-76 activity but that are not accounted for in DoD cost comparison data--unanticipated cost increases after conversion to contract and federal retirement reform. Technical adjustments by CBO for these two phenomena would reduce average dollar savings available from A-76 reviews governmentwide by about 4 percent.

Unanticipated Cost Increases

Actual savings realized from shifting activities to the private sector may be less than estimated if contracting out results in certain costs not anticipated in cost comparisons. Disputes over work requirements, for example, can lead to claims against the government. Contractors may also go out of business or fail to perform well, necessitating costly procedures to recompute contracts. Moreover, during transition, the work may be temporarily disrupted, increasing costs and reducing savings.

The allowance CBO made for cost increases reflects information from a 1986 DoD study that compared actual savings from contracting out with savings estimates contained in cost comparisons. 3/ The study covered 131 cost competitions won by contractors on the basis of comparisons completed between October 1, 1983 and October 1, 1984. After at least one full year of operation under contract, actual savings amounted to about 96 percent of the level estimated in cost comparisons.

Federal Retirement Reform

DoD cost comparison data available to CBO predates recent civilian retirement reform, which establishes a new retirement system for employees hired after December 1983. The reform will most likely lower the

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2. CBO assumes almost all jobs could be abolished under A-76 without layoffs by not filling jobs vacated as a result of quits, retirements, and other normal separations. Even under the most aggressive CBO option, full-time jobs freed up would amount to less than 15 percent of the full-time jobs vacated as a result of routine separations. Nevertheless, when A-76 affects employees with specialized skills or activities engaging large numbers of jobs, avoiding some layoffs may be difficult--especially among nondefense agencies where employment has been tight.
 3. Department of Defense, *Report to the Congress: The Department of Defense Commercial Activities Program* (April 1986), p. 3.



estimated federal cost of activities covered by future A-76 reviews by about 2.0 percent, thus reducing the savings potential of the A-76 program.

The new retirement system consists of three parts: Social Security; a basic defined benefit plan that ties pensions to years of service and earnings; and a voluntary tax-deferred thrift plan with matching employer contributions. According to OPM estimates, the new retirement system has a full cost to the government of about 24 percent of pay (representing, for new employees as a group, the accrual cost of the defined benefit plan, the government's contributions to Social Security, and the cost of the thrift plan). This amount can be compared with an accrual cost for Civil Service Retirement of 27.9 percent of pay--the rate formerly used in preparing cost comparisons at DoD. In considering the impact of retirement reform on conversions and savings under A-76, CBO assumes that contracting out and management improvements would have the end effect of reducing federal requirements for recruiting new workers, all of whom would have been covered by the new plan.

For DoD, CBO's technical adjustments reducing savings to reflect retirement reform are offset by adjustments to reflect additional savings associated with reductions in requirements for military personnel. At DoD, uniformed military personnel are sometimes used to support commercial activity. Contracting out and management improvement can free up military positions, potentially reducing recruitment needs in other areas. In fact, DoD gives priority to freeing up military positions when conducting A-76 reviews. Savings from reducing military positions, on average, could exceed the savings from reducing equivalent civilian jobs because of higher retirement costs. These additional savings, however, are not considered in DoD's cost comparison estimates.^{4/} The accrual cost for military retirement under the Military Retirement Reform Act of 1986 (P.L. 99-348), together with the government's share of costs for Social Security, is estimated at 48.1 percent of payroll. CBO calculations assume that about 20 percent of the jobs reviewed at DoD through 1992 will involve military personnel.

4. DoD cost comparison data and CBO estimates do not incorporate possible additional savings for freeing up resources associated with relatively high military pay. There is no detailed data for calculating such effects. An unpublished 1987 CBO analysis, however, suggests that after income taxes, pay for selected military positions (including allowances for subsistence and housing) stands around 5 percent above commonly compared civilian grades. If such a pattern holds for jobs covered by future A-76 reviews, CBO estimates of extra savings associated with military positions are conservative.

CONVERSION TO CONTRACT

According to data reported by DoD, conversions to contract increased from 53 percent of total in 1984 to 75 percent of total in 1986. These percentages, however, somewhat overstate conversions because data from which they are derived do not cover activities for which agencies received no bids. CBO's estimates assume a level conversion rate of 65 percent through 1992. The lower CBO rate considers that certain activities, representing about 10 percent of total, will not convert because agencies will receive no bids. CBO assumed a discontinuation in the growth of conversions to reflect revisions in cost comparison guidelines which, consistent with statutory provisions contained in the Retirement Reform Act, somewhat understate retirement costs and could therefore limit future shifts to contractor performance. Current guidelines require agencies to use an average cost for retirement set at 21.7 percent of pay. This factor excludes the cost of the new thrift savings plan and Social Security benefits. Revised guidelines also require that the contractor's costs exclude costs for Social Security and any thrift plan offered. It is unlikely, however, that private-sector providers of commercial services would offer thrift or other pension plans to their workers.

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